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IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No.

EDWIN R. MACKETHAN, Receiver of
Norfolk, Savings & Loan Corporation, *Petitioner*

v.

COMMONWEALTH OF VIRGINIA, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Petitioner, Edwin R. MacKethan, Receiver of Norfolk Savings and Loan Corporation, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fourth Circuit entered in this proceeding on December 23, 1974.

OPINION BELOW

The Per Curiam Opinion of the Court of Appeals, not yet reported, appears in the Appendix hereto. The Memorandum Opinion of the District Court for the Eastern District of Virginia also appears in the Appendix.

JURISDICTION

The judgment of the Court of Appeals for the Fourth Circuit was entered on December 23, 1974, and this petition for certiorari is filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether a State's involvement in activities prohibited by Federal Securities laws subjects it to the jurisdiction of the Federal Courts.

2. Whether evidence should have been permitted to be produced to prove that the State consented to be sued because of its conduct which was in violation of Federal Securities Law.

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS

The Eleventh Amendment to the U.S. Constitution:

> "The Judicial Power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State."

The Securities Act of 1933, 15 U.S.C. 77

1. Section 2(b) provides:

> "The term 'person' means an individual, a corporation, a partnership, an association . . . or a government or political subdivision thereof."

2. Section 17a sets out fraudulent interstate transactions and is set out in its entirety on page 1 of the Appendix.

The Securities Exchange Act of 1934, 15 U.S.C. 78

1. Section 10b making manipulative and deceptive devices unlawful is set out in the Appendix.

2. *SEC Rule 10b-5* is set out in the Appendix

STATEMENT OF THE CASE

A. Summary

On January 2, 1973, the doors of Norfolk Savings and Loan Corporation (hereinafter Norfolk Savings), an uninsured financial institution, were closed because of its long-standing insolvent condition, and a receiver was appointed. Many millions of dollars representing the life savings of thousands were lost by investors who had relied on the State to honestly and properly examine and report on the financial condition and practices of the institution connected with securities' transactions.

In a suit filed by Norfolk Savings' Receiver against the State of Virginia, he alleged in detail the State's fraudulent conspiracy with others in violating the Securities Act of 1933 [15 U.S.C. 77a, *et seq.*] and the Securities Exchange Act of 1934 [15 U.S.C 78a, *et seq.*] and SEC Rule 10b-5 thereunder. The District Court, without hearing any evidence, sustained the State's Motion to Dismiss on the ground of sovereign immunity.

B. The State of Virginia Had Long Known of the Insolvent Financial Condition and Fraudulent Practices In Connection with the Purchase and Sale of Norfolk Savings' Securities. Yet the State Willfully Violated Federal Securities Laws by Conspiring to Permit the Fraud to Continue Unabated in These Securities Transactions.

For many years before its closing, Norfolk Savings was insolvent. In addition, for each of the 15 years before 1973, the State had rated the management and

practices of Norfolk Savings either "Poor" or "Unsatisfactory." Either of these ratings is very rare for any financial institution, and is cause for great concern. No other financial institution in the State had ever had such a deplorable rating history, yet the State conspired with certain corporate officers and directors to prevent knowledge of Norfolk Savings insolvency and fraudulent practices from reaching the investing public.

As part of the cover-up, the State and some corporate officers and directors [1] used the mails and other means of interstate commerce, including telephone, radio, television, and newspapers, to solicit additional investments in Norfolk Savings' securities and to maintain a false front to existing security holders. The solicitations were materially false and misleading, representing Norfolk Savings as a safe place for investments.

By certain provisions of the Code of Virginia, duly enacted, the Commonwealth of Virginia derived its power to gain access to all books, papers, and records concerning the financial condition and practices of Norfolk Savings, for which the State charged a fee one and one-half times the rate for other banks. Blatant deviation from, and deeds unconnected with the granted powers, led to the State's active perpetration of the conspiracy consummated in the loss of millions of invested capital by security holders and the public.

---

[1] Three of Norfolk Savings officers and directors have been indicted and have pled guilty to mail fraud and other charges brought by the United States arising from the Norfolk Savings situation.

As the District Court's Memorandum points out:

> [T]he defendant, through its agencies and more specifically the Commission of Banking, perpetrated negligent and fraudulent acts in the course of its supervision . . . proximately resulted in substantial loss to holders of 'Certificates of Investment' issued by the Corporation. Indeed plaintiff alleges that 'the Commonwealth and the Board of Directors conspired to prevent the public from realizing the insolvent condition' of the Corporation.
>
> It is these alleged acts of the defendant upon which plaintiff premises his claim under the Securities Act of 1933 and more specifically Section 78(j)(b) of the Securities Exchange Act of 1934, 15 USCA 78(j)(b).
>
> [Memorandum p. 2, App. p. 5a.]

The State was charged by its statutes to examine Norfolk Savings once a year, at least. Under the Code of Virginia when the State learned of Norfolk Savings' insolvent financial condition or other irregular practices it was required to act promptly to protect those dealing with Norfolk Savings by closing the doors to further business and seeking the appointment of a receiver to handle its affairs. This action was warranted here since the State knew that many of the corporate officers and directors were misusing capital invested in its securities to their own personal advantage and against the interests of Norfolk Savings and those investing in and dealing with it.

Not only did the State permit the continuation of these illegal acts, but it actively conspired with those officers and directors to solicit and otherwise encourage further transactions involving purchases and sales of securities by and with Norfolk Savings.

Other information material to making prudent decisions concerning securities transactions was also known by the State which it intentionally covered up. This included, *inter alia,* that Norfolk Savings had twice been denied federal insurance; that an accounting firm, Peat, Marwick, Mitchell and Company, refused to certify Norfolk Savings' financial condition after conducting an audit; that certain officers and directors of Norfolk Savings were making large illegal loans to themselves, or to straw corporations,—created for their unlawful purposes—and controlled by them, their wives and nominees.

C. The State Aided and Abetted the Continued Soliciting of Purchases and Sales of Norfolk Savings' Securities by Materially False and Misleading Advertising in Interstate Commerce Which Federal Law Prohibits.

The daily operations of Norfolk Savings consisted chiefly in the purchase and sale of securities. Investors would purchase securities in the form of, *inter alia,* Certificates of Investment,[2] Certificates of Deposit, and other securities. Norfolk Savings would issue these securities to investors, as well as purchase securities in the form of long-term notes, shares of stock of other corporations, and other securities, among others. But even after the insolvent condition and highly irregular practices were known to the State, business continued unabated. Thus, all persons in-

[2] The Certificates of Investment were held as a matter of law to be securities within the Securities Exchange Act of 1934 in two suits filed in the United States District Court for the Eastern District of Virginia, Alexandria Division arising from the demise of Norfolk Savings, namely, *Edwin R. MacKethan, Receiver, etc.* v. *Landmark Communications, Inc., et. al.* (Civil Action No. 202-74-A); and, *Edwin R. MacKethan, Receiver, etc.* v. *Virginia National Bank* (Civil Action No. 203-74-A).

volved in the purchases and sales of securities were dealt with fraudulently by the State, in direct conflict with the letter and intent of the federal securities laws.

The tack taken by the State was to assist in creating the illusion to the investing public that all was well within Norfolk Savings. This was boosted by an aggressive advertising program soliciting investments which was known by the State to be materially false and misleading.

The statements made in the solicitations were material to prudent and informed securities transactions, but were untrue and failed to state material facts concerning the financial condition of Norfolk Savings and illegal practices of certain corporate officers and directors. The State failed to state those facts known to it which were necessary to make the statements made not misleading.

All of these activities by the Commonwealth of Virginia are declared unlawful by Section 17 of the Securities Act of 1933, Section 10b of the Securities Exchange Act of 1934, and SEC Rule 10b-5 promulgated thereunder.

REASONS FOR GRANTING THE WRIT

A. Summary

This Court has never decided the important question of whether a State's participation in activities which are specifically prohibited by federal law may be held to evidence a waiver of any sovereign immunity it may otherwise have and be subject to civil liability in the federal courts. The fraudulent activities with which the State is charged by your petitioner clearly are not

controlled by any decision of this Court. By allowing the State to assert the sovereign immunity as a bar to liability, the decisions below have frustrated the Federal laws pertaining to securities and weakened Congressional intent to provide investor protection. Your petitioner should not have been denied the right to produce clear evidence of the State's wrongdoing in the federally regulated areas of securities laws by which it either explicitly or impliedly consented to be sued.

B. The Decision Below Involves an Important Question of Federal Law Which Has Not Been, But Should Be, Settled By this Court.

Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78(j)(b)) and SEC Rule 10b-5 make it unlawful directly or indirectly, by the use of the mails or other instrumentalities of interstate commerce, to participate in or cover-up any fraudulent activities which makes prudent and fully-informed investment decisions impossible. No decision of this Court has addressed the important question of a State civil liability under federal law for violations of this Act.

In reliance upon this Court's decision in *Employees of the Department of Public Health and Welfare* v. *Missouri,* 411 U.S. 279 (1973), the District Court held that the State of Virginia was immune from suit for its wrongdoing under the Eleventh Amendment to the Constitution. This was affirmed, *per curiam,* by the Fourth Circuit.

The decision of the District Court recognizes that sovereign immunity may be waived by explicit or im-

plied consent and cites *Parden* v. *Terminal R. Co. of Alabama,* 377 U.S. 184 (1964) which held:

> [W]hen a State leaves the sphere that is exclusively its own and enters into activities subject to congressional regulation, it subjects itself to that regulation as fully as if it were a private person or corporation.
>
> [*Parden,* at p. 196]

Your Petitioner complains that the State left its exclusive sphere and acted contrary to congressional regulation. But the District Court denied plaintiff the right and opportunity to prove this, which is clearly erroneous.

The State of Virginia shed any governmental role it might have had when it ventured into fraudulent schemes and acts specifically prohibited by federal legislation. Congress, in exercising its powers, intended the federal securities laws to be a true source of protection for investors in securities, and to provide remedies against any wrongdoer. Throughout the nation, States exercise some supervision over securities through blue-sky laws and the like, yet the federal securities laws will have no meaning if the States are allowed to participate in federally prohibited acts with abandon. Only by this Court's resolution of the issues here presented will the positions of the nation's investors and the State, be settled.

That the State acted in a congressionally regulated area is set our clearly in the Complaint, and the extent and nature of its federally prohibited activities warrants a finding, after all the evidence is adduced, that immunity should be waived, and this question should be reviewed by this Court.

The District Court's reliance on *Employees* is misplaced because that case deals with the State acting in a *purely humanitarian* capacity, namely the operation of state mental hospitals and the like. *Employees* goes to great lengths to distinguish *Parden, supra,* and it does so on the grounds of governmental function (no waiver of immunity) versus proprietary function (waiver allowed). But, *Employees* did not address itself to the situation presented here, namely, participation by a state in fraudulent activities explicitly proscribed by federal law. If there is any way to waive immunity, that, surely, must be one.

Employees, supra, further holds that the legislative history of the Fair Labor Standards Act (subject of the action) indicated no Congressional intent to deprive a state of immunity. But Congress, in the Securities Act of 1933 did indicate such an intent. Section 2 defines a "person" as including "a government or political subdivision thereof." Section 17 of this Act makes it unlawful for any "person" to participate in the activities alleged in the Complaint. The State in the instant case is therefore "a person" within the meaning of federal securities' laws.

C. By Dismissing the Complaint for Lack of Jurisdiction on the Ground of Sovereign Immunity, the District Court Precluded the Opportunity for Plaintiff to Present Evidence Showing That the State Had Waived This Defense.

The District Court dismissed the Complaint which alleged that the State had conspired with the others and intentionally and negligently violated federal laws and regulations pertaining to securities transactions. The State did not answer, but filed a Motion to Dismiss on the ground of sovereign immunity, which the

Court sustained, without allowing the plaintiff any opportunity to prove its allegations. The Court held:

> If, indeed, as expressed by the Court during argument of the pending motion, a state proximately causes injury for which federal law would, were the act performed by an individual, provide a remedy, the bar to suit presented by the doctrine of sovereign immunity may to some, and undoubtedly to the victim does, appear unjust.
>
> Nevertheless, the doctrine is not newly conceived, and has had both constitutional and theoretical support for almost two centuries. The apparent hardships resulting from the adoption and retention of the doctrine's intended operation, as in the instant case, have long been subordinated.
>
> [Memorandum, p. 9, App. p. 11a]

The Court concluded, without benefit of any proof, that the State had not waived sovereign immunity either implicitly, or constructively, and therefore the defendant's Motion to Dismiss on that lone ground was sustained.

In effect, the decisions below held that the plaintiff could not win its case, but this is a test inappropriate on a Motion to Dismiss.

> "The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *Scheuer* v. *Rhodes,* 416 U.S. 232 (1974).

The well-established rule is that in passing on a Motion to Dismiss, the allegations of the Complaint must be construed favorably to the pleader and against the moving party. *Walker Process Equipment, Inc.* v. *Food Machinery and Chemical Corp.,* 382 U.S. 172 (1965); *Scheuer* v. *Rhodes, supra.* A complaint should

not be dismissed "unless it appears beyond doubt that plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley* v. *Gibson*, 355 U.S. 41, 45 (1957); *Gardner* v. *Toilet Goods Assn. Inc.*, 387 U.S. 167, 172 (1967).

In *Scheuer* v. *Rhodes, supra,* Mr. Chief Justice Burger, for the unanimous Court, held that it was "inappropriate" for the District Court to sustain a motion to dismiss on the ground of sovereign immunity under the Eleventh Amendment. The matter was remanded for proof of the allegations. The case now before this Court should also be remanded to allow proof of plaintiff's claim, which, fairly read, shows that the State had waived its defense of sovereign immunity. *Parden* v. *Terminal R. Co. of Alabama, supra; Dawkins* v. *Craig,* 483 F.2d 1191 (4th Cir. 1973).

Dawkins v. *Craig, supra,* relied on in the District Court's Memorandum, only serves to fortify plaintiff's contention that the merits of his case, including whether the State had waived its immunity, should be heard and adjudicated. That case was appealed to the Fourth Circuit only after a full hearing on the merits. In *Dawkins,* the Fourth Circuit recognized that while a state may waive its immunity, the evidence showed North Carolina had not done so, since its "purpose in operating an AFDC program is purely humanitarian, . . ." *Dawkins* v. *Craig, supra.*

Another test recently set out by the Supreme Court is expressed in *Edelman* v. *Jordan,* 415 U.S. 651 (1974), where it is held:

> [I]n deciding whether a State has waived its constitutional protection under the Eleventh

> Amendment, we will find waiver only where stated '. . . by such overwhelming implications from the text as will leave no room for any other reasonable construction.' *Murray* v. *Wilson Distilling Co.*, 213 U.S. 151, 171 (1909). [Edelman at p. 196]

Like *Dawkins,* the *Edelman* case was fully determined on the merits in the District Court. In that case, the Court found that the State's participation in a federally funded program to provide aid to the blind and disabled was humanitarian in nature, and thus not a waiver of immunity.

In the instant case, there was no humanitarian activity by the State. On the contrary, the State acted in a most inhumane manner, and against express federal prohibitions assisted known criminals to continue to defraud the investing public. This will be clearly proven by the plaintiff—given the opportunity.

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Fourth Circuit.

Respectfully submitted,

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March 20, 1975

APPENDIX

Statutory and Regulatory Provisions Referred to in the Text.

1. *Securities Act of 1933, Section 17a*

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser .

2. *Securities Exchange Act of 1934, Section 10(b)*

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

3. *Security and Exchange Commission Rule 10(b)-5*

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of

interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme or artifice to defraud,

(2) to make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading or

(3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 74-1249

EDWIN R. MACKETHAN, Receiver of Norfolk Savings and Loan Corporation, *Appellant*,

v.

COMMONWEALTH OF VIRGINIA, *Appellee*.

Opinion of the Fourth Circuit

Appeal from the United States District Court for the Eastern District of Virginia, at Richmond. Robert R. Merhige, Jr., District Judge

Argued December 3, 1974. Decided December 23, 1974.

PER CURIAM:

The receiver of a defunct savings and loan institution filed this Securities Act and Securities Exchange Act suit

against Virginia. He claims that state officials conspired with officers of the savings and loan to violate the securities laws. The District Court, however, dismissed on the ground that the eleventh amendment barred the suit.

Upon consideration of the briefs, record and oral argument, we affirm on the basis of the District Court's opinions in this case, *MacKethan* v. *Commonwealth of Virginia,* Civ. No. 73-547-R (E.D. Va. Jan. 16, 1973). and in a related case, *MacKethan* v. *Commonwealth of Virginia,* Civ. No. 74-0013-R (E.D. Va. July 24, 1974).

AFFIRMED.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

Civil Action No. 3-547-R

EDWIN R. MACKETHAN, Receiver of the Norfolk Savings and Loan Corporation, *Plaintiff,*

v.

COMMONWEALTH OF VIRGINIA, *Defendant.*

Order

In accordance with the memorandum of the Court this day filed, and deeming it proper so to do, it is ADJUDGED *and* ORDERED that the motion of the defendant to dismiss be, and the same is hereby, granted, and this action stands dismissed for lack of jurisdiction.

Let the Clerk send copies of the memorandum and this order to counsel of record.

/s/ ROBERT P. MERHIGE, JR.
Robert P. Merhige, Jr.
United States District Judge

Date: January 16, 1974

(Caption omitted in Printing)

Memorandum

This matter is before the Court on the motion of the defendant, The Commonwealth of Virginia, to dismiss the complaint filed herein on the grounds of lack of jurisdiction by reason of the claim sovereign immunity inherent in the State and preserved to it by the Eleventh Amendment to the Constitution of the United States.

Plaintiff, Edwin R. MacKethan, is the Receiver of the Norfolk Savings and Loan Corporation, having been so appointed by the Law and Chancery Court of the City of Norfolk, Virginia, in a suit there pending between the Commonwealth of Virginia at the relation of the State Corporation Commission of that State and the Norfolk Savings and Loan Corporation. As Receiver, plaintiff is the possessor of all claims of that corporation, its depositors, creditors and owners, and seeks here a judgment for damages in the amount of eleven million dollars.

Plaintiff alleges generally that the defendant through agencies of its State Corporation Commission negligently and/or fraudulently breached its regulatory duties with respect to the activities of the now closed Norfolk Savings and Loan Corporation. Plaintiff alleges further that the Commonwealth's breach of its regulatory duties constitutes violation of the Securities Act of 1933, 15 U.S.C.A. 78a.

Jurisdiction is sought to be invoked pursuant to 15 U.S.C.A. Section 78aa.

On the material before it, the Court deems the matter ripe for disposition.

The allegations of the complaint and argument of the plaintiff give rise to the following:

The Norfolk Savings and Loan Corporation, whose principal place of business was Norfolk, Virginia, was prior to its

closing by order of the State Court an uninsured financial institution established pursuant to the laws of Virginia.[1]

Plaintiff contends that the corporation solicited and sold through false and misleading representations made via the media, several million dollars of "Certificates of Investment."

Plaintiff's position is that the defendant, through its agencies and more specifically in the Commission of Banking, perpetrated negligent and fraudulent acts in the course of its supervision which culminated in the insolvency of the corporation proximately resulting in substantial loss to holders of "Certificates of Investment" issued by the corporation. Indeed plaintiff alleges that "the Commonwealth and the Board of Directors conspired to prevent the public from realizing the insolvent condition" of the Corporation.

It is these alleged acts of the defendant upon which plaintiff premises his claim under the Securities Act of 1933 and more specifically Section 78(j)(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. 78(j)(b).

While the Court has serious misgivings as to the correctness of plaintiff's contention reference a claim under either the Securities Act of 1933 or the Securities Exchange Act of 1934, the substantive issue need not be addressed by reason of the Court's conclusion, for reasons which follow, that the defendant's instant motion to dismiss is well taken.

The Eleventh Amendment to the Constitution of the United States, while silent on the issue of immunity reference suits against a state brought by one of its own citizens, has been

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[1] Pursuant to Va. Code Section 6.1-227, *et seq.*, Code of Virginia, 1950, as amended, the State Corporation Commission, an enforcement arm and agency of the Commonwealth is charged with the duty to supervise and regulate activities of savings and loan corporations for the protection of investors, depositors and others.

interpreted by the Supreme Court as barring federal judicial authority to hear suits allegedly arising under the Constitution or laws of the United States brought both by citizens of another state and the state's own citizens, barring the state's consent. See *Hans* v. *Louisiana*, 134 U.S. 1 (1889); *North Carolina* v. *Temple*, 134 U.S. 32 (1889); *In re State of New York*, 256 U.S. 490 (1921); *Employees of the Department of Public Health and Welfare* v. *Department of Public Health and Welfare*, 411 U.S. 279 (1973).[2] The Eleventh Amendment to the United States Constitution provides:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

That this immunity may be waived by explicit or implied consent is not open to question. See *Parden* v. *Terminal R. Co. of Alabama*, 377 U.S. 184 (1964). There being nothing before the Court tending to establish an explicit consent by the defendant, the issue then is whether, as plaintiff contends, the actions of the State in regulation activities allegedly subject to congressional regulation left the sphere which was exclusively its own and in so doing has subjected itself to the congressional regulations as

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[2] While the derivation of immunity is in any event academic, even absent the Eleventh Amendment, the exercise of federal judicial power may alternatively be barred by the implied immunity from suit by a state's own citizens arising from the protective veil of sovereignity embodied in Article III Section 2 of the Constitution. See Mr. Justice Marshall's concurrence in *Employees* v. *Missouri Public Health Dept.*, *supra*, 411 U.S. 279, 287; *Great Northern Life Ins. Co.* v. *Read*, 322 U.S. 47, 51 (1944), *Ex parte Young*, 209 U.S. 123, 150 (1908), *Duhne* v. *State of New Jersey, et al*, 251 U.S. 311 (1920); and *Dawkins* v. *Craig*, 483 F.2d 1191, 1193, n. 1 (4th Cir. 1973).

"fully as if it were a private citizen or corporation."[3] *Parden* v. *Terminal R. Co. of Alabama, supra,* 377 U.S. 184 (1964). Plaintiff in short contends that there has been an implied waiver of immunity on the part of the defendant state.

Parden, supra, is indeed the seminal case in this area. See also, *Chesapeake Bay Bridge and Tunnel District* v. *Lauritzen,* 404 F.2d 1001, 1003 (4th Cir. 1968). Nevertheless, assuming, arguendo, that the relevant activities of the Norfolk Savings and Loan Corporation were regulated by federal law, both *Parden,* and the *Chesapeake Bay Bridge* case are not only distinguishable on their facts, but the principles enunciated in *Parden* and followed by the Fourth Circuit in Chesapeake Bridge fail to support plaintiff's theory of an implied waiver on the part of the defendant.

Parden, a case wherein the State of Alabama in the operation of a state owned railroad engaged in interstate commerce, for profit, was held to have waived its immunity against suit by its employees for actions arising under the Federal Employers Liability Act, 45 U.S.C. Section 51. The Supreme Court there held that in operating a railroad, an activity usually dominated by private corporations and individuals, *Alabama* was engaged primarily in a "proprietary" as distinguished from a "governmental" function. It was held that Alabama, in performing services for profits, unlike our instant case, under statutory authority authorizing it to operate "as though it were an ordinary common carrier" waived sovereign immunity and hence was subject to suit under the federal act. The Supreme Court there, at page 191, went on to hold that

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[3] Plaintiff has cited several cases dealing with express waiver of sovereign immunity by the federal government in connection with the Federal Torts Claim Act, 28 U.S.C. Section 2671, *et seq.* These cases, *Indian Touring Co.* v. *United States,* 350 U.S. 61 (1955) and *Ingham* v. *Eastern Air Lines, Inc.,* 373 F.2d 227 (2d Cir. 1967), are not relevant to the instant issue.

"the States surrendered a portion of their sovereignity when they granted Congress the power to regulate commerce."

Plaintiff here contends that the State of Virginia has become involved in securities regulations, an area legitimately subject to Congressional supervision, and is therefore subject to suit in a federal court on the same terms as any individual creating an injury in that area for which Congress intended to provide recovery.

The broad potential implications of *Parden,* including the effective waiver of immunity for any state action touching interstate commerce, were addressed and put in perspective more recently by the Supreme Court in *Employees* v. *Missouri Public Health Dept.,* 411 U.S. 279 (1973), a case not addressed in plaintiff's brief. Granting congressional power to bring the states "to heel," whenever one injects itself into an area which Congress had legitimately seen fit to control, the Court found that intent to exercise this power was not necessarily to be assumed.

> It is not easy to infer that Congress in legislating pursuant to the Commerce Clause, which has grown to vast proportions in its applications, desired silently to deprive the States of an immunity they have long enjoyed under another part of the Constitution.

411 U.S. at 285. *Parden,* it found, dealt with "a rather isolated state activity," the entry of a state "for profit" into an aspect of commerce normally engaged in by private persons and corporations. Such proprietary state enterprises, it held, remained sufficient without more to waive sovereign immunity from suit under federal law. In *Parden,* the state had adopted the role of a private person and in such cases a congressional intent to achieve uniformity would be assumed .

But in *Employees,* the state had undertaken to run mental hospitals, cancer hospitals, and schools for delinquent girls.

These were found to be traditionally governmental functions and within the normal sphere of state activity. No profit motive was found.

In deciding whether these institutions were brought under the Fair Labor Standards Act, the Court found appropriate more hesitancy in reaching the conclusion that operation of these facilities were congressionally intended to be conditioned on the forfeiture of immunity from suit in a federal forum. In the case of traditionally "governmental" activities, the Court declined to extend *Parden* "where the purpose of Congress to give force to the Supremacy Clause by lifting the sovereignty of the States and putting the States on the same footing as other employers is not clear," 411 U.S. at 287.

Plaintiff now attempts to extend the *Parden* doctrine into the area of pure governmental regulation. Such effort, in the Court's view, must fail. The impetus toward application of the *Employees* rationale is stronger here than in the case in which it was announced. While the operation of hospitals is not necessarily a governmental function, the specific nature of the hospitals involved in *Employees* gave state activity in that area a traditional base. In the present context, the state activity attached is necessarily of a governmental nature. Regulation of securities is not an endeavor in which private persons are free to participate. If governmental ownership of non-profit mental hospitals is to be distinguished from government operation of a profit-making railroad, it is because the former is perceived more akin to those functions peculiarly reserved to and encumbent upon governments and closer to their essential purpose. Pure regulation of private conduct must be considered closer still. The "clear" congressional intent test announced in *Employees, supra,* must be applied here.

Plaintiff does not argue that Congress has expressed an intent to condition state regulation of securities on forfeiture of sovereign immunity. As heretofore discussed,

state participation in the area of securities regulation is not sufficient in and of itself to waive immunity. *Cf. Dawkins* v. *Craig, supra*, 483 F.2d 1191 (4th Cir. 1973).[4]

As the Court has endeavored to point out, both *Parden* and *Chesapeake Bay Bridge* were cases involving state activities affecting strong federal interests in the area of commerce. While not unlike many matters daily engaged in, savings and loan enterprises undoubtedly peripherally and in some instances perhaps directly affect interstate commerce. Nevertheless, the relationship is not as apparent as in *Parden* and *Chesapeake Bay Bridge*. Indeed, unlike the instant case the immediate federal interests in those cases were exclusive. In *Parden*, the Federal Act had preempted state interests with respect to that type of employee compensation. See *South Buffalo R. Co.* v. *Ahern*, 344 U.S. 367, 371-72 (1952). In *Chesapeake Bay Bridge*, the federal interest by definition was exclusive. Furthermore, in each of those cases, the respective states, unlike our instant case, were indeed engaged in the precise activities which were subject to federal regulation.

Here the state was not involved in the activities of the Norfolk Savings and Loan Corporation, which were al-

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[4] Plaintiff's reliance on *Chesapeake Bay Bridge and Tunnel District* v. *Lauritzen*, 404 F.2d 1001 (4th Cir. 1968) is impersuasive. In that case Virginia, recognizing that she could do so only by sufference of the Federal Government, had petitioned pursuant to the Act of Congress, 33 U.S.C. Section 401 *et seq.*, for permission to occupy navigable waters with bridges and tunnels.

> "The supplication of the State, and her reception into the Federal domain, meant surrender, pro tanto and pro tempore, of State sovereignty and submission to the paramount overlordship of the United States during the tenancy."

404 F.2d at 1003. No such supplication or surrender is required for the state to enter the area of securities regulation. In this case the right of regulation inheres in the state, subject only to the affirmative limitations of Congress and the Constitution.

legedly subject to federal regulation. At the most, the state's activity was limited to a regulatory system parelleling and complementing the federal regulatory scheme.

Nor can it be successfully contended that the state was engaged in even a flavorably proprietary function. Such function as the state engaged in was that of regulating business activity for the general welfare of its citizenry; a function patently not dominated by private persons or corporations, but one in which only a governmental agency is especially equipped to perform.

Plaintiff's reliance on the case of *Jordan* v. *Weaver,* 472 F.2d 985 (7th Cir. 1973), is, by reason of its conflict with the principles enunciated in *Dawkins* v. *Craig, supra,* 483 F.2d 1191 (4th Cir. 1973), the Court of Appeals by which this Court is bound, an act of legalistic futility, which could have been fruitful only if its principles had been adopted by the United States Court of Appeals for the Fourth Circuit or the Supreme Court of the United States. Additionally, the Court has considered the learned opinion of the District Court for the Northern District of Illinois in the case of *Tcheriprin* v. *Franz,* No. 64-C-1285, — F. Supp. — (1973), a case factually paralleling the instant one, and concluded that same is in conflict with those authorities by which this Court is bound.

If, indeed, as expressed by the Court during argument of the pending motion, a state proximately causes injury for which federal law would, were the act performed by an individual, provide a remedy, the bar to suit presented by the doctrine of sovereign immunity may to some, and undoubtedly to the victim does, appear unjust.

Nevertheless, the doctrine is not newly conceived, and has had both constitutional and theoretical support for almost two centuries. The apparent hardships resulting from the adoption and retention of the doctrine's intended operation, as in the instant case, have long been subordinated.

The state not having waived, either implicitly, explicitly, or constructively, its immunity and not now consenting to be sued must prevail .

An appropriate order will issue.

/s/ Robert P. Merhige, Jr.
Robert P. Merhige, Jr.
United States District Judge

Date: January 16 ,1974

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IN THE

Supreme Court of the United States

October Term, 1974

No. 74-1198

EDWIN R. MacKETHAN, Receiver of Norfolk Savings and Loan Corporation,

Petitioner,

v.

COMMONWEALTH OF VIRGINIA,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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FORM OF REFERENCE

App. ..... refers to page number of appendix attached to the Petition.

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

I.

STATEMENT OF RELEVANT FACTS

The statement of facts must necessarily be those set forth in the Complaint, which even though not admitted by the Commonwealth of Virginia (hereinafter "Commonwealth") to be true, were taken as pleaded for purposes of the Motion to Dismiss in the District Court. Those additional facts alleged in the Petition, although doing nothing to affect the legal conclusion reached by the District Court and the Fourth Circuit, are irrelevant surplusage for purposes of this appeal.

The Complaint discloses that the court-appointed Receiver of Norfolk Savings and Loan Association (hereinafter "Norfolk Savings"), an industrial loan association created pursuant to the laws of the Commonwealth,[1] is suing the

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[1] See, Title 6.1, Chap. 5, § 6.1-227, *et seq.*, of the Code of Virginia (1950), as amended.

Commonwealth in federal court, jurisdiction being founded upon the Securities Act of 1933[2] and the Securities Exchange Act of 1934 (hereinafter " '33 and '34 Acts"). Paragraphs 4 and 5 of the Complaint allege that "Certificates of Investment" issued by Norfolk Savings were "Securities" within the meaning of the '33 and '34 Acts and entitled to "investor protection" afforded by the '34 Act. All allegations are based on violations of Section 10(b) of the '34 Act [15 U.S.C. § 78j(b)] and Rule 10(b)-5 adopted thereunder. No specific reference is made to any violation of any section of the '33 Act. There is no allegation concerning the common stock of Norfolk Savings or any other instrument than "Certificates of Investment" evidencing transactions between Norfolk Savings and its depositors.

Norfolk Savings was regulated by the Virginia State Corporation Commission (hereinafter "Commission") whose duties were generally to supervise and examine it as provided in Chapter 5 of Title 6.1 of the Virginia Code. There is no allegation that the Commission operated Norfolk Savings, offered or sold any securities, nor registered any securities Norfolk Savings may have issued.[3] The Complaint alleges in extraordinarily general terms that the insolvency of Norfolk Savings was the result of the fraudulent and/or negligent state supervision of Norfolk Savings. (Complaint, paragraph 11).

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[2] Paragraph I of the Complaint incorrectly refers to the Securities Act of 1933 as the Securities Exchange Act of 1933. No violations of any sections of this Act appear to be alleged on the face of the Complaint which makes the founding of jurisdiction thereon a useless gesture.

[3] As a matter of fact, securities of industrial loan associations are exempted from registration under Virginia law by Va. Code § 13.1-514(6).

II.

ARGUMENT

A.

Federal Jurisdiction

This suit attempts to invoke federal jurisdiction over the Commonwealth to obtain damages to be paid from the public treasury, liability being based upon fraudulent and negligent state regulation. Such an action is prohibited by the Eleventh Amendment to the United States Consitution which provides:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another State, or by Citizens or Subjects of any Foreign State.

It is similarly well established that an unconsenting state cannot be sued in federal court by its own citizens. *Hans* v. *Louisiana,* 134 U.S. 1, 10 S.Ct. 504 (1890); *Duhne* v. *New Jersey,* 251 U.S. 311, 40 S.Ct. 154 (1920); *In Re State of New York,* 256 U.S. 490, 41 S. Ct. 588 (1921); *Employees of the Department of Public Health and Welfare* v. *Missouri,* 411 U.S. 279, 93 S.Ct. 1614 (1973); *Edelman* v *Jordan,* 415 U.S. 651, 94 S.Ct. 1347 (1974), reh. den., 416 U.S. 1000, 94 S.Ct. 2414 (1974); *Dawkins* v. *Craig,* 483 F.2d 1191 (4th Cir. 1973). The state's immunity from suit without its consent, obviously, does not protect it from a suit to which it has consented. *Parden* v. *Terminal R. Co.,* 377 U.S. 184, 84 S.Ct. 1207 (1964). In attempting to present some basis for consent in this case, the Receiver chose in the District Court the implied waiver theory of *Parden* v. *Terminal R. Co., supra:*

> When a State leaves the sphere that is exclusively its own and enters into activities subject to congressional regulation, it subjects itself to that regulation as fully as if it were a private person or corporation. (At 96 U.S. 196, 84 S.Ct. 1215.)

It did not work.

1. Area of Federal Securities Laws

The "activities subject to congressional regulation" which the Receiver argues the Commonwealth entered are those activities subject to the '33 and '34 Acts although the Complaint alleges no violations of the '33 Act. The '33 Act generally requires capital attracting entities to disclose to potential investors material facts about securities to be publicly offered for the first time. Disclosure is accomplished through the filing of a registration statement which must be supplied to each purchaser at or before the sale or delivery of securities. There are severe penalties for misrepresentations and fraud. The '34 Act provides for the registration and regulation of securities exchanges, the registration of securities already issued and listed on such exchanges and certain securities traded over the counter. Its purpose is to provide fair and honest markets in securities transactions. Again there are severe penalties for fraud. See generally, *Securities and Federal Corporate Law,* Bloomenthal, Harold S. (Clark Boardman Company, Ltd., and Sage Publishers, Inc., 1972).

It is doubtful that a "Certificate of Investment" is a security under the federal securities laws.[4] Far more crucial in this case, however, is the fact that there is no allegation

[4] The district court did not have to decide this point, although it had "serious misgivings" that such was the case (App. 5a), because it was so clear there was no waiver of immunity.

that the Commonwealth offered or sold any securities nor did any act as a private person or corporation as a participant in a congressionally authorized program. See, *Edelman* v. *Jordan, supra,* 415 U.S. at 672, 94 S.Ct. at 1360. In fact, the Commonwealth never "left the sphere that is exclusively its own," *i.e.,* the regulation of industrial loan associations pursuant to the police power of the states reserved by the Tenth Amendment. Banks, savings and loan associations, and similar institutions are regulated by every state in the union and there can be no doubt that this is an area "still the primary domain of the State governments." See *Dawkins* v. *Craig, supra,* at 1195. The District Court had no trouble with this point, stating:

> Here the state was not involved in the activities of the Norfolk Savings and Loan Corporation, which were allegedly subject to federal regulation. At the most, the state's activity was limited to a regulatory system parallelling and complementing the federal regulatory scheme. (App. 10a, 11a.)

See also Federal Deposit Insurance Corporation v. *Cades,* 357 F.Supp. 1111 (E.D. Pa. 1973).

2. Governmental v. Proprietary

In considering state intervention into a congressionally regulated area, the consent issue is a matter of federal law. *Parden* v. *Terminal R. Co. supra.* Even had the Commonwealth been involved in an activity subject to federal regulation, which it was not, it must have done so as "if it were a private citizen or corporation" for the implied consent theory of *Parden* to apply. This forms the basis of the "governmental v. proprietary" distinction reflected in the case of *Employees of Dep't. of Public Health & Welfare* v.

Missouri, supra,[5] which is apparent recognition of Justice Douglas' view expressed in his dissenting opinion in *Maryland* v. *Wirtz,* 392 U.S. 183, 205, 88 S.Ct. 2017, 2028 (1968) that:

> The Court must draw the "Constitutional line between the State as government and the State as trader . . . ." *State of New York* v. *United States* [326 U.S. 572, 66 S.Ct. 310 (1946)], *supra,* at 579, 66 S.Ct. at 313.

The *Employees* case presented the specific question whether the enactment of the Fair Labor Standards Act by Congress pursuant to the Commerce Clause of the United States Constitution had ". . . brought the States to heel, in the sense of lifting their immunity from suit in a federal court . . . ."[6] In holding for Missouri, the Court refused to find such consent ". . . where the purpose of Congress . . . is not clear," stating:

> Congress acting responsibly would not be presumed to take such action silently. (411 U.S. at 284-5, 93 S.Ct. at 1618.)

This rationale followed to the letter the earlier teachings of this Court in the case of *Ford Motor Co.* v. *Department of Treasury,* 323 U.S. 459, 65 S.Ct. 347 (1945), which required a "clear indication" and "clear language" as a prerequisite to such consent.

The Petitioners had argued that the *Employees* case was controlled by *Parden* which involved a state owned railroad

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[5] The Receiver's classification of *Employees* as "purely humanitarian" (Petition, p. 10) is silly.

[6] Justice Douglas says this question was left open by *Maryland* v. *Wirtz,* 392 U.S. 183, 88 S.Ct. 2017 (1968). See, *Employees, supra,* at 411 U.S. 283, 93 S.Ct. 1617.

operating in interstate commerce and the claims of its employees arising under the Federal Employer's Liability Act. In distinguishing *Employees,* the majority explained that in *Parden* Alabama had operated the railroad "for profit" and "in the area where private persons and corporations normally ran the enterprise," and the difference in *Employees* was that

> State mental hospitals, state cancer hospitals, and training schools for delinquent girls which are not operated for profit are not proprietary. (411 U.S. at 284, 93 S.Ct. at 1617.)

The majority recognizing "how pervasive such a new federal scheme of regulation would be" (411 U.S. at 285, 93 S.Ct. at 1618) if they held that "the States surrendered their [immunity from suit in federal court] . . . when they granted Congress the power to regulate commerce,"[7] (411 U.S. at 286, 93 S.Ct. at 1619) was unable to find "a direct federal court remedy," (411 U.S. at 287, 93 S.Ct. at 1619) and declined

> . . . to extend *Parden* to cover every exercise by Congress of its commerce power, where the purpose of Congress to give force to the Supremacy Clause by lifting the sovereignity of the States and putting the States on the same footing as other employers is not clear. (411 U.S. at 286-7, 93 S.Ct. at 1619.)

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[7] In the case of *Kirschbaum* v. *Walling,* 316 U.S. 517, 520, 62 S.Ct. 1116, 1118 (1942) cited by the Court to illustrate the breadth of the Commerce Clause, it is said:

> To search for a dependable touchstone by which to determine whether employees are "engaged in commerce or the production of goods for commerce" is as rewarding as an attempt to square the circle.

This same reasoning was further strengthened and *Parden* further limited in the case of *Edelman* v. *Jordan, supra,* 415 U.S. at 673, 94 S.Ct. at 1360-1:

> Constructive consent is not a doctrine commonly associated with the surrender of constitutional rights, and we see no place for it here. In deciding whether a State has waived its constitutional protection under the Eleventh Amendment, we will find waiver only where stated "by the most express language or by such overwhelming implications from the text as will leave no room for reasonable construction." *Murray* v. *Wilson Distilling Co.,* 213 U.S. 151, 171, 29 S.Ct. 458, 464, 53 L.Ed. 742 (1909).

The District Court pointed to this Court's explanation in *Employees* that *Parden* "dealt with 'a rather isolated state activity,' the entry of a state 'for profit' into an aspect of commerce normally engaged in by private persons and corporations" (App. 8a) and that in the instant situation the Commonwealth was not engaged "in even a flavorably proprietary function." (App. 11a.) Accordingly, it held:

> Plaintiff now attempts to extend the *Parden* doctrine into the area of pure governmental regulation. Such effort, in the Court's view, must fail. The impetus toward application of the *Employees* rationale is stronger here than in the case in which it was announced. While the operation of hospitals in not necessarily a governmental function, the specific nature of the hospitals involved in *Employees* gave state activity in that area a traditional base. In the present context, the state activity attacked is necessarily of a governmental nature. Regulation of securities is not an endeavor in which private persons are free to participate. If governmental ownership of nonprofit mental hospitals is to be distinguished from governmental operation

> of a profit-making railroad, it is because the former is perceived more akin to those functions peculiarly reserved to and encumbent upon governments and closer to their essential purpose. Pure regulation of private conduct must be considered closer still. The "clear" congressional intent test announced in *Employees, supra,* must be applied here.

The implied waiver theory having thus proved unsuccessful before the District Court, the Receiver attempted to construct an additional theory of express waiver before the Fourth Circuit. He again failed but now raises it in this Court, a matter to which we briefly turn.

3. Congressional Intent

In spite of the fact that the Receiver does not allege that the Commonwealth operated this industrial loan association, issued any securities, registered any securities, nor did any act under the Securities Act,[8] he nevertheless contends that had the Commonwealth done some such act under the '33 Act, there is a clear congressional waiver of Eleventh Amendment rights in that particular Act.[9] In support of this academic contention, he cites 15 U.S.C. § 77(b)(2) which defines a "person" to be "a government or political subdivision thereof." This is the same argument that was made

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[8] Any allegation that any state official may have been guilty of fraud, which is denied, would be properly dealt with in an action against such official personally. This point was made by the district court in a second action brought by the Receiver against the Commonwealth involving the same matter. [*MacKethan* v. *Commonwealth,* Civ. No. 74-0013-R (E.D. Va. July 24,)], cited with approval by the Fourth Circuit (App. 3a) and attached hereto as Exhibit A.

[9] Of course, Section 10(b) and Rule 10(b)-5 are under the '34 Act and no contention is made that there is a clear congressional waiver under this Act.

and rejected in *Employees*[10] where it was pointed out that the Fair Labor Standards Act defined "employer" to cover "employees of a State or a political subdivision thereof, employed . . . in a hospital, institution, or school. . . ." It had previously been held in *Maryland* v. *Wirtz, supra,* that this definition brought the states under the substantive provisions of that Act, but *Employees* was unequivocal in pointing out that this definition alone was not the clear congressional expression necessary to overcome the constitutional constraints on "the judicial power" of the United States embodied in the Eleventh Amendment.

Moreover, § 17 (15 U.S.C. 77q) of the '33 Act, if it provides a private civil remedy at all, and § 10(b) [15 U.S.C. 78j(b)] of the '34 Act are court implied private civil causes of action such as were judicially molded in *J. I. Case Company* v. *Borak,* 377 U.S. 426, 84 S.Ct. 1555 (1964). *Borak* was a case which found that although there was no specific reference to a private right of action in § 14(a) of the '34 Act [15 U.S.C. § 78n(a)], such a private right of action was implied "... where necessary to make effective the congressional purpose." (377 U.S. at 433, 84 S.Ct. at 1560.) No such private action, however, will be authorized where the effect is to bring an unconsenting state into the federal court:

> And while this Court has, in cases such as *J. I. Case Co.* v. *Borak* (cit. omitted), authorized suits by one private party against another in order to effectuate a statutory purpose, it has never done so in the context of the Eleventh Amendment and a state defendant. *Edelman* v. *Jordan,* 415 U.S. at 673-4, 94 S.Ct. at 1361.

[10] Of course, in *Employees* the state was a participant in the program authorized by Congress. *Edelman* v. *Jordan, supra,* 415 U.S. at 672, 94 S.Ct. at 1360.

There is clearly no congressional expression of intent to waive the Eleventh Amendment protection in § 17 of the '33 Act or § 10(b) of the '34 Act.

B.

The Eleventh Amendment Is Absolute

The Receiver cites the cases of *Scheuer* v. *Rhodes*, 416 U.S. 232, 94 S.Ct. 1683 (1974); *Edelman* v. *Jordan, supra*, and *Dawkins* v. *Craig, supra*, for the proposition that a state's immunity is qualified thus making it inappropriate to sustain a motion to dismiss without receiving evidence as to the scope of the immunity. He is wrong. The Eleventh Amendment protection is absolute.

Scheuer v. *Rhodes* merely states that the immunity of *public officials* is not absolute but qualified, a holding consistent with prior case law and not the landmark the Receiver represents it to be. This Court went to great lengths to make clear that the rationale of that case was "... no aid to a plaintiff seeking damages from the public treasury ..." [11] but was applicable only in a case involving the personal liability of "... individual defendants ... [who] hold public office." [12] The Court was equally unequivocal in *Edelman* v. *Jordan* that:

> ... a suit by private parties seeking to impose liability which must be paid from public funds in the state treasury is barred by the Eleventh Amendment. (415 U.S. at 663, 94 S.Ct. at 1356.)

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[11] 416 U.S. at 238, 94 S.Ct. at 1687.

[12] *Id.*

Dawkins v. *Craig* is absolutely consistent in holding that "... relief [which] looks directly to the payment of public funds out of the State treasury ... is contrary to the Eleventh Amendment."[13]

It is difficult to misread these cases in the manner in which the Receiver has done. The fact that other cases may not have been decided on a motion to dismiss is of no relevance. The Receiver points out on page 11 of his Petition that the allegations of the Complaint must be taken as true for purposes of the motion to dismiss. There is nothing left for him to prove because the Commonwealth has taken every allegation as true for such purposes and the action is clearly barred by the Eleventh Amendment.

III.

CONCLUSION

This case was decided below on principles firmly entrenched in our system of jurisprudence. The Receiver's allegations do not present any foundation for a *Parden* waiver under either the '33 or '34 Acts as the Commonwealth never left the area that was exclusively her own nor entered into activities subject to congressional regulation as a private person or corporation. The State merely performed the governmental function of regulator. Furthermore, there is no "clear congressional intent" to waive the states' Eleventh Amendment protection in the federal securities laws, and especially is this so when dealing with a court implied private cause of action. The decision below was plainly right and

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[13] 483 F.2d at 1194.

no important unsettled question of federal law is presented herein. The Petition for Certiorari should be denied.

Respectfully submitted,

COMMONWEALTH OF VIRGINIA

By:

Counsel

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CERTIFICATE OF SERVICE

I hereby certify that on this 17th day of April, 1975, three true and correct copies of the Brief in Opposition to Petition for Certiorari were mailed, postage prepaid, to Oren R. Lewis, Jr., Esquire, Lewis, Wilson, Cowles, Lewis & Jones, Ltd., counsel for plaintiff, 2054 North 14th Street, Arlington, Virginia 22216.

HENRY M. MASSIE, JR.
Assistant Attorney General

EXHIBIT A

In The
UNITED STATES DISTRICT COURT
For The Eastern District Of Virginia
Richmond Division

Civil Action
No. 74-0013-R

Edwin R. MacKethan, Receiver
Norfolk Savings & Loan Corp.

v.

Commonwealth Of Virginia, et al

MEMORANDUM

Filed July 24 1974

This matter is before the Court on the motion of the defendant, the Commonwealth of Virginia [hereinafter referred to as the State], to dismiss the complaint filed herein as to it. Similar motions by other of the defendants which are now pending, and some of which are still awaiting plaintiff's response, will not be considered herein.

Plaintiff, Edwin R. MacKethan, is the Receiver of the Norfolk Savings and Loan Corporation, having been so appointed by the Law and Chancery Court of the City of Norfolk, Virginia, in a suit there pending between the Commonwealth of Virginia at the relation of the State Corporation Commission of that State and the Norfolk

Savings and Loan Corporation. As Receiver, plaintiff is the possessor of all claims of that corporation, its depositors, creditors and owners, and seeks here a judgment for damages against the various defendants in the amount of eleven million dollars.

As relates to its claim against the State, the plaintiff alleges generally that the State, through agents of its State Corporation Commission, negligently and/or fraudulently: one, breached its regulatory duties with respect to the activities of the now closed Norfolk Savings and Loan Corporation; and two, participated in the dissemination of false or misleading information to investors in said corporation by failing to disclose relevant information in its possession.

Jurisdiction is sought to be invoked pursuant to 15 U.S.C. § 78aa.

Prior to the filing of this action, the instant plaintiff had filed a related action in this Court naming the State as the sole defendant. *MacKethan* v. *Commonwealth of Virginia,* Civil Action No. 73-547-R. Subsequent to the filing of the present action, wherein additional defendants were joined, the Court dismissed the previous action on jurisdictional grounds. The Court there held that jurisdiction was lacking by reason of the State's sovereign immunity, inherent in the State and preserved to it by the Eleventh Amendment to the Constitution of the United States. See *MacKethan* v. *Commonwealth of Virginia,* C.A. No. 73-547-R, *mem. decis.* Jan. 16, 1974 (E.D.Va.)

The defendant's motion in this action likewise raises the bar of sovereign immunity as grounds for dismissal.

As to the first count in plaintiff's present complaint, it is obvious to the Court that said count must be dismissed for the reasons stated in the memorandum accompanying the

order dismissing the plaintiff's previous related action against the State. *MacKethan* v. *Commonwealth of Virginia,* C.A. No. 73-547-R, *mem. decis.,* Jan. 16, 1974 (E.D.Va.). That is because the first count in the present complaint simply incorporates by reference all of the allegations contained in the complaint filed in the previous action referred to.

The additional allegations in Counts II and IV of the present complaint relate essentially to claims brought against defendants other than the State in this action, and are therefore irrelevant to the motion presently before the Court.

As to the third count in the present complaint, which does attempt to raise a claim against the State, the plaintiff contends that same is a "new claim" and that the reasoning behind the decision in the previous action does not apply with respect to this "new claim." The plaintiff asserts that the "new claim" in Count III, unlike the claim previously asserted, fails within an exception to the bar of sovereign immunity.

I.

RES JUDICATA

To be more specific, the plaintiff contends that the claim raised in the previous action and incorporated into Count I of this action, was premised on a theory that the State had breached its state statutory duty of supervising the aforementioned savings and loan corporation's securities transactions and was therefore liable for the resultant damages to depositors, creditors and owners. The plaintiff argues, however, that the claim raised in Count III of the instant complaint is based on the state's alleged complicity in the dissemination of false or misleading information to investors in the aforementioned savings and loan corporation, in clear violation of federal securities laws.

The Court would begin by pointing out that it did not construe the plaintiff's previous action as having been so narrowly drawn as plaintiff now suggests.[1] In its memorandum dismissing the complaint therein the Court stated at one point:

> . . . Indeed plaintiff alleges that "the Commonwealth and the Board of Directors conspired to prevent the public from realizing the insolvent condition" of the corporation.
>
> It is these alleged acts of the defendant upon which plaintiff premises his claim under the Securities Act of 1933 and . . . the Securities Exchange Act of 1934 . . .

C.A. No. 73-547-R, *mem. decis.*, jan. 16, 1974, at p. 2 (E.D. Va.).

Indeed, had the Court viewed the previous claim as having been based solely on the defendant's alleged breach of its state statutory duties, it would never have reached the issue of sovereign immunity. Absent the element of an alleged federal securities violation, the plaintiff's claim would simply have amounted to a state claim. Under that circumstance, regardless of the state's alleged waiver of sovereign immunity, the Court would have been totally lacking subject matter jurisdiction, which is the first prere-

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[1] Courts, of course, decide cases on the basis of facts presented. While it is hoped that the litigants will aid the Court by drawing attention to the relevant principles of law, courts do not limit their inquiry, with regard to the applicable legal principles, to the arguments presented by the litigants.

Moreover, noting the various arguments which the plaintiff advanced in the previous action, the Court ascribes plaintiff's present suggestion that the prior complaint was as narrowly drafted as he now contends, to be no more than the exercise of a lawyer's prerogative not to necessarily accept his own arguments as being conclusive of any given issue,—in short, one does the best he can with what he has.

quisite to maintaining an action in federal court. See *Mansfield, Coldwater & Lake Ry.* v. *Swan,* 111 U.S. 379 (1884); *Minnesota* v. *Northern Securities Co.,* 194 U.S. 48, 62-63 (1904).

Beyond that, the Court would further note that the only apparent difference between the plaintiff's "old claim" and his "new claim" is in the theories on which they are premised. The factual allegations do not appear to differ materially. While a new hair-do may create a new woman, as certain advertisements suggest, a new legal theory does not make a new cause of action. *Moreno* v. *Marbil Productions, Inc.,* 296 F.2d 362 (5th Cir. 1961); *Norman Tobacco & Candy Co.* v. *Gillette Safety Razor Co.,* 295 F. 2d 362 (5th Cir. 1961). The doctrine of *res judicata* applies to jurisdictional issues, as well as to substantive matters. See *Stoll* v. *Gottlieb,* 305 U.S. 165, 172 (1938); *Baldwin* v. *Iowa State Traveling Men's Ass'n.,* 283 U.S. 522 (1931). Therefore, even assuming the Court had not given the previous complaint the full breadth of consideration justified by the allegations set forth therein, the present action would still be barred by the doctrine of *res judicata.* See, *id.* The plaintiff's only relief would be by way of appeal.

Finally, there is no doubt that the present action arises out of the same series of occurrences that was subject to controversy in the previous action. Assuming further that the plaintiff had come forward in the present complaint with *new* factual allegations bearing on the sovereign immunity question, the new action would still be barred under the doctrine of *res judicata.* This is because a plaintiff may not litigate his claim piecemeal. See *Heiser* v. *Woodruff,* 327 U.S. 726, 735 (1946), and cases cited therein. Repetition, whether in presenting new theory *or pleading additional facts,* is not to be tolerated. See *Lester* v. *National Broad-*

casting Co., 217 F. 2d 399 (9th Cir. 1955), *cert. denied*, 348 U.S. 954 (1955), *rehearing denied*, 349 U.S. 917 (1955). See also, *Kriesel* v. *Berkshire Associates, Inc.*, 452 F.2d 491 (4th Cir. 1971) (deciding the issue under Virginia law).

II.

SOVEREIGN IMMUNITY

The essence of plaintiff's contention in this regard, throughout this and the previous litigation, has been that the state had expressly or impliedly waived its sovereign immunity.

In the memorandum dismissing the previous complaint, the Court concluded that it could find no Congressional intent to pre-condition the State's entry into the field of securities *regulation* on the State's consent to be sued for claims arising out of that activity. *MacKethan* v. *Commonwealth of Virginia*, C.A. No. 73-547-R *mem. decis.* Jan. 16, 1974 (E.D. Va.). *Cf., Parden* v. *Terminal R. Co. of Alabama*, 377 U.S. 184, 187-191 (1964) with *Employees* v. *Missouri Public Health Dept.*, 411 U.S. 279, 287 (1973). Accordingly, no implied waiver was found.

The only theory not previously addressed is plaintiff's apparent contention that, by participating in the dissemination of false or misleading information, incidental to its regulatory action, the State agency involved left the sphere of legitimate governmental activities, and thereby became a mere "lawbreaker." The plaintiff argues that the State thereby "waived" its immunity for actions arising under the federal securities legislation.

This contention, in the Court's view, misconceives the doctrine of sovereign immunity. There is no issue but that action which violates superior federal law is outside the scope

of legitimate state activity, regardless of the state authority relied upon. *Ex parte Young,* 209 U.S. 123, 159-160, 163, 166-68 (1908). The state functionary involved is, in a sense, a law breaker. The theory is that although the state functionary may be acting under color of state law, his actions are not the official actions of the state. *Id.* It is basic that the simple act of violating superior federal law does not establish a waiver of sovereign immunity merely because the state, through its functionaries, has thereby left its legitimate sphere of activities.[2] See *Hans* v. *Louisiana,* 134 U.S. 1, 10 (1889); *Smith* v. *Reeves,* 178 U.S. 436, 446-49 (1900).

Moreover, the plaintiff's argument fails to distinguish this case from *Employees, supra,* 411 U.S. 279. There was no question in *Employees* that the state employer was covered by the substantive provisions of the Act there in question. 411 U.S. 282. On a motion to dismiss, the state employer in *Employees* was presumed to have been in violation of the standards set forth in that legislation. *Employees,* therefore, also involved a clear violation of superior federal law; but no waiver of sovereign immunity was found.

As to the question of Congressional intent, upon which the issue of an implied waiver of sovereign immunity ultimately turns, the Court recognizes that Section 2 of the Securities Act of 1933, 15 U.S.C. § 77(b)(2), defines a "person" to include "a government or political subdivision thereof;" and that Section 17 of the Act, 15 U.S.C. § 77(q), makes it unlawful for any "person" to fraudulently participate in the dissemination of false or misleading information with regard to the sale of securities. Even assuming arguendo that this

[2] Assuming, however, that the state functionaries involved had not been acting in good faith, it may be that they would be liable, in their individual capacities, for their participation in the alleged federal securities violation. *Cf. Pierson* v. *Ray,* 386 U.S. 547, at 555-557 (1967); *Monroe* v. *Pape,* 365 U.S. 167 (1961).

statutory scheme might properly be interpreted as establishing a Congressional intent to precondition direct participation by the various states in the marketing of securities on a waiver of sovereign immunity as to any violations of the Act that might occur in the process, see *Parden* v. *Terminal R. Co., supra,* 377 U.S. 184, 187-191;[3] plaintiff must still fail, for he has not alleged facts sufficient to establish direct state involvement, either as principal or agent, in the marketing of securities. The relevant state legislation provides for the regulation of savings and loan company activities, which may include supervision over the marketing of securities by such organizations. See Va. Code § 6.1-237, *et seq.,* Code of Virginia 1950. That legislation does not, however, contemplate *active* participation by the state in the process of marketing the securities. Any indirect involvement by the state in such activities would be merely incidental to the state's performance of its regulatory function. Under any interpretation of the federal securities legislation in question, the Court cannot conceive that Congress intended to precondition the state's engaging in a regulatory function, such as that here present, on a waiver of sovereign immunity as to any securities violations that might occur with regard to the activities of the regulated organizations.

To reiterate, the state's function here was regulatory, which is a purely governmental function. The implications of Congressional intent with regard to the coverage of the Securities Act of 1933 might be quite the opposite had the state here been a principal or participant in a proprietary

[3] The Court does not, however, here determine that such interpretation is necessarily appropriate. Further analysis might lead to the conclusion that even under this statutory scheme the remedies available against the states for violations of the Act are limited by the Eleventh Amendment to exclude private damages actions. See *Employers* v. *Missouri Public Health Dept., supra,* 411 U.S. 279, 285-86.

function which necessitated also its active participation in the public sale of securities to finance the venture.[4] *Cf. Parden* v. *Terminal R. Co., supra,* 377 U.S. 184, with *Employees* v. *Public Health Dept., supra,* 411 U.S. 279.

It may be, as alleged, that certain state functionaries participated directly with others in the dissemination of information which ultimately proved to be false or misleading. Were that participation in the public information activities of the savings and loan company officially sanctioned by the regulatory legislation under which the state functionaries had been acting, the argument for an implied waiver would unquestionably be stronger. In such a situation the official state involvement in the securities marketing activities would have to be viewed as more direct. However, the legislation here in question does not, on its face, contemplate even good faith participation by state functionaries in the dissemination of corporate financial information to the investing public. See Va. Code, § 6.1-237, *et seq.* Therefore, any such participation which may in fact have occurred would have been ultra vires in its inception, and cannot be viewed as a waiver, by the state, of its sovereign immunity.

Finally, the Court takes note of the plaintiff's objection that the issue of sovereign immunity is not ripe for determination on a motion to dismiss. Suffice it to point out that, regardless of what the evidence may show as to the unofficial activities of the state functionaries involved in this matter, no proof of facts can change the purely regulatory nature of the legislation under which they were acting. In the absence of more, no implied waiver of sovereign immunity can be found; and no express waiver is apparent.

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[4] It is not uncommon for municipal corporations and other governmental subdivisions to join with private enterprise in the marketing of securities to finance, for example, industrial parks.

For the reasons stated, the state's motion to dismiss will be granted, and the action will be dismissed as to the state.

An appropriate order shall issue.

/s/ ROBT. R. MERHIGE, JR.
United States District Judge

Date: JUL 24 1974